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## Rating Bill May Ease Strictures

*Rep. Frank Sees Tax Code Changes*

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By [Andrew Ackerman](#)

WASHINGTON The legislation that House Financial Services Committee chairman Barney Frank, D-Mass., is planning to introduce within the next week or so to require credit agencies to rate municipal securities on the same scale as other types of bonds may also include two provisions to help banks and corporations buy more munis, a knowledgeable source said this week.

The provisions would loosen restrictions in the 1986 Tax Reform Act that decreased the amount of tax-exempt income that banks and corporations could report, but also had unintended adverse consequences on governments and nonprofit issuers, according to market sources. Frank could not be reached for comment. A spokesman would only confirm that the congressman plans to introduce the legislation soon.

But the knowledgeable source said that Frank is considering proposing an increase in the tax law's so-called bank deductibility limits, which currently allow banks to deduct 80% of the costs of purchasing and carrying the bonds of states and localities whose annual bond issuance does not exceed \$10 million.

Issuer groups have asked lawmakers to boost the cap to \$30 million, though it is not clear if Frank plans to adhere to that specific request. A spokesman for the House Ways and Means Committee, which has jurisdiction over tax issues, did not return phone calls for comment. Prior to 1986, when Congress imposed the \$10 million limit for issuers whose bonds could be bank-deductible, banks were much larger purchasers of tax-exempt debt, particularly for small governments.

Market participants have noted that any changes to the provisions on bank deductibility should specify, for conduit deals, that the issuance limit applies to the borrower rather than the issuer.

The Government Finance Officers Association and five other issuer groups told Rep. Paul Kanjorski, D-Pa., chairman of the committee's capital markets panel in a March letter, that few statewide issuers of debt, including debt for non-profit education and health care, are unable to issue any bank-qualified bonds because the exemption is applied to the issuer, not at the borrower or beneficiary level.

Separately, the knowledgeable source said that Frank is also considering increasing private sector investment incentives for purchasing tax-exempt bonds by altering the 2% de minimis rule, so-called because it allows corporations to deduct the costs of interest on their debt, without having to prove that they did not borrow to buy the bonds, as long as tax-exempt bonds are 2% or less of total assets.

"We would argue that 2% is excessively low," the issuers wrote in their letter. "If the percentage of

allowable tax-exempt assets were increased, corporations would be able to legitimately invest more in bonds, without running afoul of IRS [rules]."

The legislation, which Frank announced earlier this month that he was drafting, follows through on a threat he made in March to legislatively force the three major rating agencies to rate municipalities on a global-equivalent scale if the rating agencies do not do so voluntarily.

At a March hearing, Frank said separate rating scales for municipalities and corporate issuers were hurting muni issuers because municipalities historically have had much lower default rates than other kinds of debt.

But as long as the separate scales exist, he said, municipalities are forced to purchase insurance, which he described as an unnecessary expense that is dragging down the value of muni bonds in light of the widespread downgrades to bond insurers. He called insurance "the lead life preserver" for bonds, and said, "you'd be better off without the preserver."

Since his remarks, the issue of a single global rating scale has found some traction. Moody's Investors Service last week altered its plan of offering both municipal and global scale ratings for municipal bonds and instead proposed migrating its municipal scale so that it is in line with its other global ratings.

The move may have been partly influenced by Frank's warnings, and by California Treasurer Bill Lockyer, who led a high-profile campaign to overhaul the current system used by the rating agencies.

Standard & Poor's says that it already has a global scale which is used across all sectors. Some market participants initially questioned the scale but later supported it after learning the rating agency has upgraded hundreds more municipal bonds to triple-A status than Moody's.

The only major rating agency that has yet to embrace a universal scale is Fitch Ratings, which said in a statement that it continues to consider the idea.

"For several months Fitch has been engaged in a broad review of the possible harmonization of corporate and public finance ratings with municipal market issuers and investors," said David Weinfurter, a managing director at the rating agency. "Fitch will continue to work constructively with chairman Frank and others to move this issue forward."

In a related matter, members of the GFOA, meeting in Ft. Lauderdale Tuesday, did not approve a drafted policy statement on credit ratings, asking that the policy position be made stronger than drafted in support of a unified rating scale.

The statement's language, which was drafted by the group's committee on governmental debt management Saturday, said credit rating agencies should rate munis and corporate bonds on a "readily comparable" and transparent basis. In a nod to market participants who want to maintain some degree of gradation between different muni credits, the statement also said: "Measures should be maintained to retain qualitative distinctions that are valuable to issuers and investors alike."

GFOA officials stressed yesterday that the group's debt committee, executive board and membership support a unified rating scale and will work on amending the statement. It was not clear when the membership will next have a chance to approve it.

Meanwhile, GFOA members approved two separate policy statements supporting legislation that would allow the Federal Home Loan Banks to provide letters of credit for small bond deals and ban the patenting of tax strategies, technologies, and business practices in the municipal market.